

Board of Governors of the Federal Reserve System

REPORT ON THE AUDIT OF THE BOARD'S EFFORTS TO IMPLEMENT PERFORMANCE MANAGEMENT PRINCIPLES CONSISTENT WITH THE RESULTS ACT



OFFICE OF INSPECTOR GENERAL



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

July 11, 2001

The Honorable Roger W. Ferguson, Jr.
Vice Chairman and Administrative Governor
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Governor Ferguson:

We are pleased to present our *Report on the Audit of the Board's Efforts to Implement Performance Management Principles Consistent with the Results Act (A0004)*. Our audit assessed the current status of the Board's implementation efforts and evaluated the benefits of fully integrating Results Act concepts into the Board's planning and budgeting process. As discussed in the report, the Board has not achieved its objective of voluntarily complying with the Results Act. We believe the Board should adopt an enhanced performance-management culture that emphasizes obtaining and using results-oriented information to manage its programs and operation and improving the accountability of staff.

Our report contains four recommendations designed to enhance the Board's current planning and budgeting process. While there are many positive aspects to the current planning and budgeting process, we believe some key performance-management characteristics need to be added such as setting a longer-range planning horizon with a Boardwide planning focus, establishing specific performance indicators and measures, and developing expanded performance reports that show the levels of achievement relative to the performance measures.

We provided a draft of this report to the Staff Director for Management, and met with him and his staff to discuss our recommendations. The Staff Director for Management's comments on our draft report indicates general agreement with our recommendations and discusses the actions planned or already taken (see appendix 1). We will follow up on implementation of our recommendations and report any exceptions as part of our future audit activities.

A copy of this report is being sent to each member of the Board and selected staff. The report is available to the public on our website and a summary will appear in the next semiannual report to the Congress.

Sincerely,

A handwritten signature in black ink, appearing to read "Barry R. Snyder", is written over a horizontal line.

Barry R. Snyder
Inspector General

Enclosure

Board of Governors of the Federal Reserve System

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BACKGROUND

The Congress passed the Government Performance Results Act of 1993 (Results Act) as part of a legislative framework to instill performance-based management in the federal government. The Results Act requires agencies to establish a management system to set agency goals for program performance and to measure results against those goals. The Results Act came about in response to the Congress' findings that (1) waste and inefficiency in federal programs was undermining the confidence of the American people, (2) managers' efforts to improve program efficiency and effectiveness were hampered due to insufficient articulation of program goals and inadequate information on program performance, and (3) spending decisions and program oversight were handicapped by insufficient attention to program performance and results. The Results Act was intended to (1) hold federal agencies accountable for achieving program results, (2) improve federal programs effectiveness and public accountability by promoting new focus on results, service quality, and customer satisfaction, and (3) help federal managers improve service delivery by requiring that they plan for meeting program objectives and by providing them with information about program results and service quality.

The Results Act has two major components – the incorporation of the performance management concepts of strategic planning and performance measurement into agencies' planning and budgeting processes, and the issuance of plans and reports to the Congress. Regarding the reporting requirements, the Results Act calls for federal agencies to prepare five-year strategic plans, annual performance plans, and annual performance reports. A strategic plan, which must be updated at least every three years, presents an agency's mission and establishes general long-range goals and objectives for the major functions and operations of the agency. Annual performance plans describe more specific performance goals and measures that will be used to address the goals identified in the strategic plan. Finally, annual performance reports assess agency accomplishments for goals and measures set forth in the performance plan.

While the Results Act applies to agencies receiving appropriations from the Congress, the Board of Governors of the Federal Reserve System (the Board),¹ made the decision in July 1997 to voluntarily comply with the substance of the act. Since the Congress attaches significant importance to the Results Act and has conducted hearings on agencies' implementation of the act, the U.S. General Accounting Office (GAO) and Inspectors General are conducting and coordinating reviews and analyses of agencies' plans, reports, and efforts to adopt performance management concepts.

When the Board agreed to voluntarily comply with the Results Act in July 1997, it stated to the Congress its strong support for the Results Act's premise that governmental organizations should plan strategically and measure results. Towards that end, the Board initially submitted required plans to the Congress on a timely basis and established an objective to better incorporate Results Act fundamentals, which include strategic planning, performance measurement, and performance reporting, into its planning and budgeting process by May 1999. Specifically, in October 1997, the Board submitted a strategic plan for the period 1997 – 2002 to the Congress, and in July 1998, the Board sent the Congress a biennial performance plan for the years 1998 and 1999.

¹ Section 10, paragraph 4, of the Federal Reserve Act explicitly states that Board funds "shall not be construed to be government funds or appropriated moneys."

However, since that time, the Board has not achieved its objective to better incorporate Results Act concepts, nor has it finalized and submitted the initial performance report nor subsequent strategic and performance plans. Table 1 describes the current status of the Board's Results Act documents.

Table 1
Status of the Board's Results Act Documents

Required Results Act Documents	Due Dates ²	Issue Dates
<i>Strategic Plan</i> (updated at least every 3 years) 1997 – 2002	September 1997	October 1997
2000 – 2005	September 2000	In Process
<i>Performance Plan</i> ³ (biennial) 1998 – 1999	July 1998	July 1998
2000 – 2001	August 1999	In Process
<i>Performance Report</i> (biennial) 1998 – 1999	June 2000	In Process

OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit objectives were to assess the current status of the Board's implementation efforts and to evaluate the potential benefits of fully integrating Results Act concepts into the Board's planning and budgeting process. To accomplish these objectives, we met with Board officials and staff to increase our knowledge of the Board's planning and budgeting process and Results Act activities. We reviewed the Results Act, Office of Management and Budget interpretative

² The Board is unique compared to government agencies in that it prepares its budgets biennially instead of annually and uses a calendar year rather than a September 30 fiscal year. Consequently, the Board decided to issue performance plans and reports biennially and may submit these documents three months after other federal agencies.

³ Although the Results Act does not specify a due date for the performance plan, the date should directly link to the budget submission date. Therefore, an August due date for these plans would be consistent with the time that budgets are sent to the Board for approval. However, for the Board's initial performance plan, the House Committee on Banking and Financial Services established a due date of July 1998.

Act activities. We reviewed the Results Act, Office of Management and Budget interpretative guidance, as well as internal planning, budget and human resources documents for four Board divisions for the period 2000-2001. In addition, we reviewed the Board's *Planning Document 1997-2002* and the *Biennial Performance Plan 1998-1999* that were submitted to the Congress in 1997 and 1998 as well as observations made by the GAO in November 1998 on the Board's performance plan. More recent Results Act plans and an initial performance report were not available for review by the completion of our fieldwork in February 2001. Our audit was conducted in accordance with generally accepted government auditing standards.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

The Board has not achieved its objective of voluntarily complying with the Results Act, which includes fully integrating Results Act performance management concepts into its current planning and budgeting process. We believe that its efforts have been diminished by a lack of top-management support and a perception that Results Act activities were a paper intensive process of producing reports.

We see many benefits from adopting a results-oriented, performance-based management culture for the Board. We believe that it would help direct and guide the organization by

- clearly defining the goals to be accomplished during the planning and performance periods, and the priority and budget emphasis it places on specific programs, operations, activities, and functions;
- identifying the Boardwide and program-specific strategies it will use to realize desired results; and
- developing and communicating to all levels of management the criteria that will be used to measure the success of the strategies and the organization's overall accomplishments.

While there are many positive aspects to the current planning and budgeting process, we believe it could be enhanced by adding some key performance-management characteristics such as a longer-range planning horizon with a Boardwide planning focus, specific performance indicators and measures, and expanded performance reports that show the levels of achievement relative to the performance measures. Provided below are more specific recommendations to enhance the current process. More importantly, however, we believe that the Board will need to develop a performance management framework to successfully adopt a more results-oriented management approach. Our first recommendation outlines the elements we think are needed in such a framework.

1. We recommend that the Board establish a framework to adopt a more results-oriented performance management approach.

While the Board established an objective in July 1998 to better incorporate Results Act fundamentals into its planning and budgeting process, it did not effectively communicate the

importance of complying with the Results Act or establish a framework to provide adequate guidance. This general lack of direction led to unstructured Results Act activities with no substantive actions taken to address the July 1998 objective. Going forward, it is important that an adequate framework be established if the Board is to fully incorporate performance management fundamentals into its planning and budgeting process. In developing that framework, the Board should consider

- communicating its support of a results-oriented performance-based management approach;
 - defining the roles and responsibilities for performance management among oversight governors and committees, division management, Staff Planning Group (SPG), and the Finance Function's Program Analysis and Budget staff;
 - providing training to various levels of staff regarding performance management purposes and techniques, especially for persons responsible for developing and revising performance goals, objectives, strategies and indicators; and
 - identifying and developing tools needed to instill and support a performance management culture, such as policies and procedures and a cost accounting system to categorize Board costs along programmatic or functional lines.
- 2. We recommend that the Board revise its strategic planning process to develop a long-range, Boardwide strategic plan.**

Strategic planning and the preparation of a comprehensive long-range strategic plan helps ensure that an organization clearly articulates its mission, goals, and objectives, as well as the strategies, systems, and structures that it needs to achieve them. Strategic plans also promote consistency of purpose and coordination of actions among the organization's components and assist management in setting and communicating priorities, allocating resources consistent with those priorities, and addressing important overarching issues.

Although the Board prepared the *Planning Document 1997-2002* for the Federal Reserve System in its initial effort to voluntarily comply with the Results Act, this strategic plan was not used to establish priorities or allocate budget resources, and has not been updated for use in the Board's current planning and budgeting process. The Board's current process is detailed and requires divisions to develop division-specific planning documents; primarily, to cover the next two-year planning horizon. The SPG has been established by the Board to assist and advise the Board's Committee on Board Affairs in identifying planning issues and gathering information relative to those issues. As part of its work, the SPG reviews resource levels, program allocations, and strategic initiatives. These activities are associated with the Board's biennial budget preparation and tend to have a division-by-division focus. In an April 1998 memorandum to the Board's Budget Committee, the SPG stated that the development of a Boardwide strategic plan would be beneficial. We agree. A more comprehensive strategic plan would make the current planning process more tangible, establish a clearer understanding of the purposes and functions of the Board, and communicate to staff, and the public, those projects and issues which management believes are most important.

3. We recommend that the Board establish specific, quantifiable, results-oriented performance measures that are aligned from the strategic plan to the performance objectives and expectations of division officers, managers, and staff.

A key element of performance management is an integrated system of measurement that allows management to assess the success of the agency and its staff in accomplishing the organization's mission, goals and objectives. To the extent possible, the indicators used to evaluate performance should be outcome-oriented, reasonably challenging, and subject to reliable measurement. Also, the system of performance measurement should link agency measures, generally disclosed in public reports, to internal measures used for day-to-day operations and the appraisal of staff performance. When linked to the expenditure of resources, the measures of performance should help agency officials make better decisions about the budget and staff.

While we found that the Board had developed some performance measures, many of those measures are not specific, quantifiable, linked to service quality, or outcome-based. The Board's agency-level performance measures are generally disclosed in the Results Act documents along functional lines, with measures identified for Banking Supervision and Regulation (BS&R) and Payment Systems and Financial Services (PS&FS).⁴ In November 1998, the GAO reviewed the performance measures included in the Board's 1998-1999 biennial performance plan and concluded that additional outcome measures would be useful. Based on our review of that Results Act plan, we agree with the GAO's assessment and believe that additional outcome-based performance measures would help focus Board officers, managers and employees on fully achieving program goals, objectives and strategies. In our view, the performance measures for the BS&R and PS&FS functions are not sufficient to measure the quality of supervisory processes, reports, or priced services provided. In addition, for the Division of Reserve Bank Operations and Payment Systems (RBOPS), there are no performance measures to gauge the success of its oversight responsibility.

To instill performance management at the Board, we believe that all divisions, including support functions, should be challenged to develop useful results-oriented objectives and measures that will provide better information about the effectiveness of their programs and staff. Although there has been no coordinated effort at the Board to develop or improve performance measures, the Divisions of BS&R and Consumer and Community Affairs (C&CA) have indicated that they plan to develop better performance measures and to use those measures to run their supervisory programs.

We also found that the agency-level performance measures in the Results Act documents are not linked to the goals and objectives included in the Board's biennial programs and objectives, or in the performance appraisals of senior officers.⁵ For example, only the BS&R output measure on

⁴ As a matter of Board policy, no measures were developed for the Monetary Policy function. The reasons for this policy are that (1) the Congress has not chosen to establish quantitative objectives for monetary policy in statute and (2) monetary policy has only a partial and indirect influence on economic performance. The biennial performance plan also discloses measures and targets for internal Board support.

⁵ We reviewed the objectives included in the October 2000 Performance Management Program forms for senior Board staff, defined as the director, deputy director, and associate director, of BS&R, C&CA, and RBOPS.

the timely processing of applications was included in the Board's 2000-2001 programs and objectives, while none were included in the appraisals of the BS&R director, deputy director, and associate directors. By linking the Board's goals to performance measures and then to staff performance standards, we believe that employees would be more focused toward achieving the Board's goals, objectives, and initiatives.

4. We recommend that the Board revise its internal performance reports to include comparisons of actual program results with established performance goals and measures.

Our review of the Board's internal performance reports revealed that they do not contain sufficient results-oriented data to determine how successful the Board has been in achieving its performance goals and objectives. The quarterly and annual performance reports prepared by the Board show the amount expended compared to budgeted amounts, and contain discussions of events affecting over and under expenditures and trend analysis of activities affecting future expenditures. We believe, however, that this type of comparative information has limited utility in assessing the performance of key programs and making appropriate adjustments to the budget. The mere fact that a program's expenditures fall within budgeted parameters does not provide assurance that the program has been successful in meeting its performance goals and objectives.

In addition, based on the general questions that the SPG posed to division directors during the strategic planning process, it is clear that management wants more results-oriented data to assist them in analyzing program performance. For example, one question posed by the SPG was, "What activities have declined in value to the point that they should be significantly reduced or stopped?" To enable management to make more informed decisions regarding the allocation of future budget resources, we believe that the Board's performance reports should be expanded to include a comparison of actual results with established performance goals and measures. This revised reporting format would allow the Board to show the link between resources used and program results, highlight programs and activities that have been successful in achieving performance goals, as well as to identify under-performing programs and activities and provide explanations for why performance goals were not met.

ANALYSIS OF COMMENTS

We provided a draft copy of this report to the Staff Director for Management for his review and comment. His response, included as appendix 1, indicates general agreement with the four recommendations. While he agrees in part with our recommendation that the Board establish a framework to adopt a more results oriented performance-management approach (recommendation 1), he indicates disagreement on the specific elements to be included in such a framework and the current status of those elements. The elements listed in our report were provided for consideration and were not intended to be all-inclusive.

Additionally, while he concurs in part with our recommendation that the Board establish specific, quantifiable, results-oriented performance measures (recommendation 3), he anticipates this will be difficult and the Board will likely end up with a blend of performance-based

outcomes as well as outputs. We believe that a combination of both performance-based outcomes and output measures would provide better information about the effectiveness of program operations.

Appendixes

Appendix 1 – Staff Director for Management's Comments



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

STEPHEN R. MALPHRUS
STAFF DIRECTOR FOR MANAGEMENT

DATE: June 14, 2001
To: Barry Snyder
FROM: Steve Malphrus *SRM*
SUBJECT: Comments on the draft OIG Report, *Report on the Audit of the Board's Effort to Implement the Government Performance and Results Act (Report)*

Thank you for the opportunity to review and comment on the draft *Report*. I have discussed the draft with the Associate Director of Finance and the Vice Chairman. We are in general agreement with the basic thrust of the report that the Board's current planning process is effective but needs to be better integrated with Results Act reporting. We also agree that it is very challenging for a policymaking organization like the Board to succeed in developing outcome-based performance measures. Such measures are much easier to construct for operational or service-to-the-public agencies. Our plan is to engage expert assistance to work with senior Board staff to develop outcome-based performance measures to augment our program output measures.

Where possible, we will increase our efforts to implement Results Act principles in future planning processes. A draft Results Act strategic plan was recently provided to division directors for their comments.

Specific Comments

1. We recommend that the Board establish a framework to adopt a more results-oriented performance management approach.

Concur in part. While we may differ on the specific elements to be included in such a framework and the current status of those elements, more formal guidance will be prepared and provided to the Board's directors to better integrate Results Act concepts in the current planning processes along the lines discussed in the report.

2. We recommend that the Board revise its strategic planning process to develop a long-range, Boardwide strategic plan.

Concur. The strategic plan issued in mid-1997 should be updated after three years (and every three years thereafter) to be consistent with the Results Act. As indicated, a draft plan has been drafted and distributed to directors for comment.

3. We recommend that the Board establish specific, quantifiable, results-oriented performance measures that are aligned from the strategic plan to the performance objectives and expectations of division officers, managers, and staff.

Appendix 1 – Staff Director for Management’s Comments (Con’t)

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Concur in part. Again, we anticipate this will be difficult, and we will likely end up with a blend of performance-based outcomes as well as programmatic outputs. In 1999, we worked with staff from other federal financial regulatory agencies and a GAO representative to develop performance measures. This resulted in limited success. However, with your assistance, we are going to seek outside expertise to help us draft performance measures. As you know, many federal policymaking organizations are struggling with the same problems we have encountered in defining performance-based outcomes. The move to outcomes rather than outputs is, from our perspective, a process that will entail adjustments as we learn over the next several years.

4. We recommend that the Board revise its internal performance reports to include comparisons of actual program results with established performance goals and measures.

Concur. Once determined, measures will be the benchmark of internal performance reports. Currently, performance reports focus on programmatic and financial performance as well as the status of projects highlighted in the planning and budget process. The reports identify problems at the programmatic level and discuss the status of projects. The information is provided on a timely basis to permit the Board, if they desire, to obtain, weigh options, make decisions, alter priorities and so forth.

I have asked Steve Clark to work with your staff to help identify experts that have worked with policymaking agencies to construct performance-based outcomes. Please call if you have questions.

cc: Vice Chairman Ferguson
Steve Clark

Appendix 2 – Glossary^(a)

Balanced measures

An integrated and complimentary mix of input, output, and outcome performance measures to provide structure to an organization's operations, ensure that desired performance is achieved, and that no one aspect performs to the unplanned detriment of other areas of operation or performance.

General goal

Included in a strategic plan, this goal defines how well an agency will carry out its mission over a period of time. The goal is expressed in a manner which allows a future assessment to be made of whether the goal was or is being achieved. General goals are predominantly outcome-type goals.

General objective

Included in a strategic plan, an objective is paired with a general goal and can be used to assess whether a general goal was or is being achieved. An objective usually describes a more specific level of achievement than a general goal.

Input performance measure

A measure of resources available to carry out a program or activity (i.e., to achieve an output or outcome).

Outcome goal

An outcome goal describes the intended result, effect, or consequences that will occur from carrying out a program or activity.

Outcome performance measure

An assessment of the results of a program activity compared to its intended purpose. Program outcomes can result from an interplay of several factors, some of which are not within a program's control.

Output goal

An output goal describes the level of activity or effort that will be produced or provided over a period of time or by a specified date, including a description of the characteristics and attributes (e.g., timeliness) established as standards in the course of conducting the activity or effort.

Output performance measure

A tabulation, calculation, or recording of an activity, product, service or effort that can be expressed in a quantitative or qualitative manner. Program outputs are generally produced on a daily basis and are intended to contribute to program outcomes.

^(a) Source of definitions – primarily the Results Act, the OMB Circular No. A-11, Part 2, and GAO documents.

Appendix 2 – Glossary

Performance goal

A targeted level of performance in a performance plan expressed as a tangible, measurable objective against which actual performance or achievement can be compared – including a goal expressed as a quantitative standard, value, or rate. Performance goals can be either outcome goals or output goals.

Performance indicator

A particular value or characteristic used to measure program output or outcome. Performance indicators are associated with performance goals in a performance plan.

Performance management

A comprehensive approach to focusing the management and staff of an organization on achieving desired program outcomes and results to accomplish its mission, goals, and objectives. It requires strategic planning, setting priorities, establishing performance measures, monitoring operations, measuring results, analyzing and reporting on results, and allocating resources. To create incentive, it provides rewards for achieving goals and identifies nonperformance.

Performance measure

A performance goal or indicator. Performance measures are the yardsticks to assess an agency's success in meeting its program goals.

Performance measurement

The primary mechanism for the ongoing monitoring and reporting of program accomplishments, particularly progress in achieving preestablished agency and departmental goals. It ensures that goals, objectives and measures for key programs and activities are results-oriented, reasonably challenging, and subject to reliable measurement. Performance measurement links a balanced set of agency measures to internal measures for day-to-day operations and staff performance appraisals. In addition, it continuously seeks to make improvements to performance goals, objectives and measures.

Program outcomes

The results of delivering a program's products or services.

Program outputs

The products and services delivered.

Results-oriented

A quality of performance management that relates to determining the extent to which intended program outcomes have been achieved. While the Results Act emphasizes the use of program outcomes and outcome performance measures, it recognizes that program outputs and output performance measures traditionally used by agencies to measure performance remain critical to program management.

Appendix 3 – Principal Contributors to this Report

Stanley Weidman, Senior Auditor and Auditor-in-Charge

Cynthia Gray, Auditor

Lori Jackson, Auditor

Nancy Perkins, Program Manager